Bottom Fishing

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The initial reaction to a bad news report is often overdone.

Content:

When the market is a bit funky, it is obvious that the last thing you want to do is release bad news, but the rules are the rules and when someone announces they have missed earnings or revenues the punishment is quick and severe. But its usually overdone! For instance is it right to cut a stock in half when the worst thing they said is that sales were off by 10%? More times than not the market overreacts to everything and this can be a great buying opportunity for you. If you see enough charts for enough years it is quite clear that the initial reaction to a bad news report is often overdone and the stock pops back a bit on a rebound. This is called a "dead cat bounce" in market language. But what we are focusing on isn't really a dead cat bounce, its bottom fishing and that is a bit different.

Here is the scenario: A company announces that they beat estimates but revenues were a bit soft. That causes a huge panic and they sell off the stock in a big way. So a stock that was 30 on Tuesday morning closes at 18 that night! Then Wed. comes and it pops back up a bit (the dead cat bounce), maybe getting to 21 or so. But very often that dead cat bounce is met with some more selling as the market moves on to slaughter some other poor company. Finally the stock settles in somewhere around 20 dollars and sits there for quite a while. This is where it gets interesting to watch it. A lot of times that thing will sit and crawl along that 20 dollar line for a long time, just wiggling up a 1/2 and down a 1/2 for a week or two. But in todays market, CEO's and CFO's can't afford to have their stock just sitting because shareholders are so well informed and so interested. (shareholders are very quick to start lawsuits today) So the company will generally go out of its way to release "good" news in hopes of getting the stock back in favor. Sometimes it works, and sometimes it doesn't but it rarely causes any additional selling, so buying these "bottom dwellers" is generally pretty safe. If the company was doing well before it released its "poor numbers", it will often pick up about half of what they originally lost in a matter of a few more weeks.

So watch for these "big slams" and jot them down. If you are really fast, you can day trade the "dead cat bounce", but if you are a position player, ignore the bounce, and wait for the "settle in". Once its clear that the bulk of the selling is gone and the stock has bottomed, taking a nibble is often a good way to pick up a few points. One important note here is that you MUST wait for at least 3 to 5 trading days after it seems to have "bottomed". You have to be sure the bottom is really set, or you can get trapped in a bounce. Another good idea is to do this type of bottom fishing on good, well known companies. Don't try this on the "blah blah" company, because they may never come back. But when a leading tech stumbles, its often just a gift to us! So watch for these opportunities, they can pay off big.

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